Public Service Commission of Wisconsin
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BEFORE THE

PUBLIC SERVICE COMMISSION OF WISCONSIN

Application of Wisconsin Electric Power Company, Wisconsin Gas LLC, and Wisconsin Public Service Corporation for Declaratory Ruling and Approval Regarding Long-Term Natural Gas Storage and Transportation Arrangements	Docket 5-DR-112

APPLICANTS' COMMENTS ON STAFF MEMORANDUM

The Applicants, Wisconsin Electric Power Company ("Wisconsin Electric"), Wisconsin Gas LLC ("Wisconsin Gas"), and Wisconsin Public Service Corporation ("Wisconsin Public Service") (collectively the "Gas Utilities") appreciate the opportunity to comment on the Commission staff memorandum, which provides an analysis of the Gas Utilities' proposal (1) to acquire ownership-like rights to Bluewater, a natural gas storage facility in Michigan, in the form of long-term gas storage service agreements, and (2) to enter into new long-term gas transportation arrangements to make use of that facility for about a third of their natural gas storage requirements.

The staff memorandum confirms that this innovative proposal will deliver savings to customers by reducing the Gas Utilities' future costs of gas storage and transportation. Rather than continuing to rely solely on short-term gas storage service from out-of-state providers, this arrangement will enable the Gas Utilities to acquire a long-term, lower-cost storage resource dedicated to their use for their customers. The arrangement will also provide a long-term hedge against potential shortages and high prices of leased storage in the future. Staff identified no deficiencies in the Gas Utilities' economic analysis showing about $200 million in net present value benefits to customers. (Staff Mem. at 15) Even after "stress testing" that analysis by

applying alternative assumptions unfavorable to the proposal, staff found that the proposal will benefit customers in all but the most extreme worst case scenarios. (*Id*. at 16-22)

Despite the Bluewater proposal's clear benefits to customers, the staff memorandum introduces a number of "potential" conditions that appear to have the purpose of protecting customers from all risk of a long-term commitment to gas storage. These conditions are inconsistent with the intent and structure of the proposal and would jeopardize WEC's ability to close on the transaction. The proposal is structured in a manner that would dedicate Bluewater to public utility service on terms and conditions mirroring what the cost structure and cost recovery would be if the Gas Utilities were to own Bluewater. In particular, Applicants oppose staff's proposed conditions that would treat the acquisition of Bluewater differently than a traditional public utility investment by creating regulatory reopeners to revisit the reasonableness of the long-term gas storage agreements (Potential Conditions 6-9). Such conditions would simply shift risk to the Gas Utilities and their shareholders without any compensation for the increased risk (such as a higher return). Such conditions would not be appropriate if the Gas Utilities were acquiring Bluewater directly and they are not appropriate here.

The Gas Utilities decided against directly purchasing Bluewater because doing so would have required numerous FERC approvals, including certification of the Gas Utilities as providers of interstate gas services. In addition to jeopardizing the Gas Utilities' ability to dedicate Bluewater to public utility service, converting the Gas Utilities to interstate gas storage providers would have exposed their customers to the risks of having to provide such services to third parties under FERC-jurisdictional tariffs. However, the Gas Utilities' corporate parent, WEC Energy Group, Inc. ("WEC") decided to acquire Bluewater for the benefit of the Gas Utilities' customers in a structure that ensured recovery of the facility's costs in a manner that resembles

utility ownership. Through the proposed ownership-like contractual structure, the Gas Utilities' customers will be responsible for the facility's costs and risks and will be entitled to all of its benefits, just as they would with a utility-owned and rate-based asset. Shareholders will have the opportunity to earn only a blended average of the Gas Utilities' authorized returns, just as they would with a utility-owned and rate-based asset. Staff's proposed modifications inappropriately shift risk and responsibilities to WEC and its shareholders without any corresponding benefit.

The Gas Utilities seek the Commission's concurrence that this innovative approach for acquiring cost-based gas storage capacity for about one-third of their customers' storage requirements is reasonable and prudent. Instead of attaching conditions that would increase the risk of the arrangement to WEC with no corresponding benefit, the Commission should decide whether the risk to customers under the terms of the gas storage service agreements is essentially the same as it would be if the Gas Utilities owned Bluewater outright. In order to further ensure that their customers bear the same balance of cost, risk and benefit that they do with a utility-owned asset, the Gas Utilities offer the following modifications to the long-term gas storage agreements:

- Although they believe that the proposed 60-year term of the gas storage service agreements is reasonable, if the Commission determines that a shorter or longer term is more appropriate, the Gas Utilities would accept the term and make the appropriate changes to the agreements provided that the full investment in the Bluewater storage facility is recovered over that same term.
- The Gas Utilities would agree to modify the gas storage service agreements to reduce the threshold for their unanimous approval of a significant capital expenditure by Bluewater Natural Gas Storage LLC ("BGS") to $2.5 million, instead of the $7.5 million threshold

proposed in the Application, provided that the Commission makes clear in its order that it is making no determination as to the application of the cost thresholds to individual utilities under Wis. Stat. § 196.49(5g)(ar)1m. Any capital expenditure in excess of the $2.5 million threshold, regardless of its allocation among the Gas Utilities, will be presented to the Commission for its review in the form of a Certificate of Authority ("CA") filing.

The Gas Utilities would agree to these conditions provided that the Commission otherwise confirms the reasonableness and prudence of their entering into the proposed gas storage and transportation arrangements without conditioning the Gas Utilities' future recovery of their costs.

With this as background, the Gas Utilities provide the following detailed comments on the staff memorandum in the order that they are presented in the memorandum.

1. Depreciable Life

The staff memorandum expresses two contradictory concerns about the proposed 60-year term of the gas storage service agreements. On one hand, staff suggests that the Gas Utilities' proposed recovery of the investment in Bluewater over the 60-year term is too short because it could operate for much longer and even have salvage value thereafter. (Staff Mem. at 4-5) On the other hand, staff suggests that a 60-year contract term is too long and conditions may be necessary to "to help mitigate potential risks" to customers. (Staff Mem. at 20) The Gas Utilities address these potential conditions in Section 6 below.

With respect to the depreciable life over which the investment in Bluewater should be recovered, the Gas Utilities are open to a different depreciable life than the one proposed, provided that the depreciable life is synced with the contract term. While Bluewater likely has a longer operational life, the Gas Utilities proposed a 60-year term to be conservative. There was

no intent to reserve for the holding company any benefit of operations or any salvage value beyond that timeframe. The Gas Utilities would be agreeable to recovering the investment in Bluewater over 90 years provided the terms of the gas storage contracts were extended accordingly. Though 90 years is an extraordinarily long term for a contract, it would be appropriate in this case because the intent is to mimic the Gas Utilities' ownership of Bluewater.

On the other hand, if the Commission shares staff's concerns about the risk associated with long-term ownership of gas storage, then the proposed 60-year term provides customers with a degree of protection from that risk. But not allowing the investment in Bluewater to be recovered over that period (i.e., by depreciating the investment over a period longer than a 60-year contract term) would inappropriately shift the risk of stranded investment to the Gas Utilities' shareholders with no corresponding benefit or reward, while customers receive 100% of the benefits of the facility over the 60-year term. Thus, the depreciable life must coincide with the contract term.

The Gas Utilities would not favor a term shorter than 60 years because the rate impacts to customers in the early years of the contract term would increase accordingly. But if the Commission found a shorter term more reasonable, the Gas Utilities would accept it if the full investment in the Bluewater facility was recovered over that shorter term.

2. Acquisition Premium[1]

The staff memorandum identifies the [redacted] acquisition premium being paid for the Bluewater facility, a [redacted] difference between the purchase price and the facility's book value. The Commission's Uniform System of Accounts provides the Commission with discretion to

[1] The acquisition premium is not to be confused with transaction costs, the costs (consultant costs, legal fees, etc.) of accomplishing the Bluewater acquisition. The staff memorandum indicates no concerns regarding the recovery of the transaction costs as part of the $230 million acquisition cost.

allow a gas utility's recovery of an acquisition premium (or loss). Account 406, Amortization of Gas Plant Acquisition Adjustments, is "debited or credited, as the case may be, with amounts includible in operating expenses, pursuant to approval or order of the Commission, for the purpose of providing for the extinguishment of the amount in account 114, Gas Plant Acquisition Adjustments." The Gas Utilities' recovery of the [redacted] acquisition premium in this case is appropriate given the clear and substantial benefits of the transaction to customers − benefits that staff does not dispute.

The staff memorandum cites an unpublished "internal Commission memorandum dated April 17, 1983" as establishing "criteria" by which the Commission may decide whether to allow an acquiring utility to recover an acquisition premium. (Staff Mem. at 5) A non-public memorandum that was apparently never acted upon by the Commission does not establish precedent. Moreover, judging from the reference to revenues from "the selling utility's customers" (Staff Mem. at 6), the criteria identified appear to relate to mergers and acquisitions of utilities, not the acquisition of plant.

Here, the recovery of the acquisition premium should be considered in the context of the acquisition of assets to be dedicated to public utility service. In that context, the Commission in 2006 authorized the Town of Florence to amortize over 20 years on a straight line basis the 81% acquisition premium the town paid Wisconsin Electric for electric distribution facilities in connection with the transfer of 318 customers. The town paid $1,473,407 for facilities having a net book value of $812,821, yielding an acquisition premium of $660,686. The Commission approved the amortization of the acquisition premium because the transaction had overall customer benefits: "The integration of the WEPCO facilities into Florence's distribution system will substantially reduce the average length of distribution feeder line per customer thus

decreasing customers' exposure to outages, lowering system losses and improving service outage levels. The integrated facilities will also provide alternative sources of power during outages." Certificate and Order, *Joint Application of Wisconsin Elec. Power Co. and the Town of Florence,* Docket 5-BS-151, 2006 WL 2473941.[2]

Here, the acquisition premium is [redacted] over the net book value of the Bluewater gas storage facility. The premium is dwarfed by the $200 million in NPV customer benefits that the transaction will provide under the base case economic analysis deemed "robust" by staff. Accordingly, inclusion of the premium in the acquisition cost to be recovered from the Gas Utilities over the term of the gas storage agreements is perfectly appropriate.

3. Prior Commission Review of Capital Expenditures

Recognizing that maintaining a gas storage facility is capital intensive and seeking to mirror utility ownership of Bluewater, the Gas Utilities proposed to have the Commission review and approve future capital expenditures in excess of $7.5 million. This amount is three times the $2.5 million threshold for an individual gas utility to seek a Certificate of Authority ("CA") for new plant that it will construct or acquire. Wis. Stat. § 196.49(5g)(ar)1m.[3] The staff

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[2] The order also provided that rate recovery of the acquisition premium would be considered in the town's next rate proceeding. There is no mention of the acquisition premium in the town's 2009 rate order; since the premium was not expressly disallowed, the town presumably was allowed to recover the annual amortized amount in its rates. Final Decision, *Town of Florence,* Docket 2000-ER-105 (Nov. 19, 2009).

The Commission also allowed, without discussion, recovery of the [redacted] million acquisition premium portion of the total $27 million purchase price paid by Wisconsin Electric in 2012 when it purchased the Montfort Wind Energy Center from Badger Windpower, LLC. As with the Bluewater facility, the wind turbines at Montfort are dedicated to public utility service, and Wisconsin Electric demonstrated clear customer benefits arising from the acquisition. Final Decision, *Application of Wisconsin Electric Power Company for Authority to Purchase the Montfort Wind Energy Center, Iowa County, Wisconsin, from Badger Windpower, LLC*, Docket 6630-EB-103 (December 20, 2012).

[3] As a FERC-regulated entity, BGS need not obtain this Commission's approval for capital expenditures under Wis. Stat. § 196.49. Rather, the CA process would be initiated by the Gas Utilities in a joint filing seeking concurrence in their approval for BGS to undertake a large capital expenditure that will be funded by the Gas Utilities under the gas storage service agreements.

memorandum takes the position that, because the statutory threshold is based on the gross cost of the capital project, the Gas Utilities should be required to seek a CA for any capital improvement costing more than $2.5 million, irrespective of the fact that that the cost would be allocated three ways. (Staff Mem. at 6) The Gas Utilities disagree with this interpretation of the statute and are aware of instances in which the threshold has been applied based on how a capital investment in a joint-owned asset is allocated between utilities.

Nonetheless, if the Commission concludes that in this particular case it desires to review and approve every capital investment at Bluewater in excess of $2.5 million (escalated every two years to be consistent with the published threshold in accordance with Wis. Stat. §196.49(5g)(b)), the Gas Utilities are willing make the appropriate changes to the gas storage service agreements. Given that this statute does not directly apply to the unique circumstances presented in this Application, the Commission need not make a determination in its order as to the applicability of the CA threshold to public utilities under Wis. Stat. § 196.49(5g)(ar)1m.

4. Jurisdictional Issues (Potential Conditions 2-5)

The staff memorandum summarizes the Gas Utilities' jurisdictional analysis set forth in their March 17, 2017 Brief on Jurisdiction (PSC REF#: 299530, public) and accurately describes the basic principle governing the Commission's jurisdiction in this docket: "where a retail utility has a choice among suppliers, the Commission, rather than FERC, may evaluate whether the retail utility was prudent in selecting a particular supplier among available alternatives." (Staff Mem. at 13) By the same token, FERC has exclusive jurisdiction over the rates, terms and conditions of interstate gas service transactions, and state commissions may not disallow a retail utility's recovery of costs incurred in such transactions. *E.g., Kentucky West Virginia Gas Co. v. Pennsylvania P.U.C.*, 837 F.2d 600, 606 (3rd Cir.), *cert. denied*, 488 U.S. 941 (1988). With

these principles in mind we turn to the four jurisdiction-related conditions proposed in the staff memorandum.

Potential Condition 2 would prohibit the Gas Utilities "from incurring a charge under the proposed transaction except in accordance with Wisconsin law or from seeking to reflect in rates any cost incurred or revenue earned under the proposed transaction except as permitted by the Commission in this docket." (Staff Mem. at 12) Staff's proposal of this condition is surprising because it would be preempted by federal law: it expressly reserves authority for a state commission to disallow costs incurred by the Gas Utilities pursuant to the gas storage agreements. Those agreements are developed and adopted under BGS's FERC-approved market-based rate tariff, not a state-regulated tariff. Further, the condition is not a prerequisite to the Commission's authority to issue the declaratory ruling requested here. The Commission is asked to review the Gas Utilities' choice to enter into and incur the costs associated with the proposed long-term gas storage and transportation arrangements in light of the alternatives available to the utilities, not the reasonableness of the rates, terms and conditions of the agreements themselves.

Potential Condition 3 − "requiring provisions in the storage service agreements stating that the applicants have entered into them with their affiliate BGS or BGH voluntarily and are not obligated to make any purchases" (Staff Mem. at 13)[4] − seems to reflect confusion as to the nature of the proposed transactions. While the Gas Utilities have a choice to enter into the gas storage agreements, once they have entered into the agreements each of the utilities will be allocated a share of Bluewater storage capacity and the associated cost akin to ownership. In

[4] This condition is taken from a 2006 decision by the North Carolina Utilities Commission approving a holding company merger. There, the commission required additional approval before the newly-affiliated utilities began transacting. A state requirement prohibiting a retail utility from entering into FERC-jurisdictional obligations with an affiliate would raise both preemption and interstate commerce issues.

addition, requiring that the Gas Utilities' utilization of the storage capacity allocated to them be "voluntary" would achieve no real purpose, as the Gas Utilities will be paying for the capacity whether they use it or not, just as if they owned Bluewater. To the extent this condition is instead intended to preserve Commission jurisdiction to disallow the Gas Utilities' recovery of their cost of storage under the gas storage agreements, that purpose is preempted for the reasons already stated.

Potential Condition 4 would prohibit the Gas Utilities "from asserting the Commission is preempted from assessing the reasonableness and prudence of the applicants' decision to enter the service storage [sic] agreements with BGS or BGH or related matters in the future." (Staff Mem. at 13 n.7) The Gas Utilities have no objection to this condition, though any review of costs or rates under the storage service agreements would still be preempted, and it is difficult to identify any future Commission reassessment of reasonableness or prudence that would not be barred by the prohibition against retroactive ratemaking.

Finally, under Potential Condition 5, the Commission would order the Gas Utilities to file the gas storage agreements with the Commission for a jurisdictional determination before they are filed with FERC. (Staff Mem. at 13)[5] This condition is unnecessary because the Commission does not have jurisdiction to review the merits of the gas storage agreements under the affiliated interest statute, Wis. Stat. § 196.52. In addition, the condition would delay the closing of the Bluewater acquisition and create additional uncertainty.

[5] As support for this condition, staff points to the application of Wisconsin Electric and Wisconsin Public Service pending in Docket 5-AE-208 for approval of a capacity sale agreement under Wis. Stat. § 196.52. (Staff Mem. at 13 n.8) As the applicants in that docket have clarified, they filed that agreement with the Commission because an order point (19) of the decision approving WEC's acquisition of Integrys Energy Group required the utilities to enter into "appropriate agreements including affiliated agreements under Wis. Stat. § 196.52," if an integrated resource plan demonstrated "that savings can be achieved by sharing resources among subsidiaries." Final Decision at 42, *Wisconsin Energy Corp.*, Docket 9400-YO-100 (May 21, 2015). There, as here, while the Commission has authority to review the utilities' choice to enter into that agreement, the Commission lacks jurisdiction over the agreement's rates, terms or conditions.

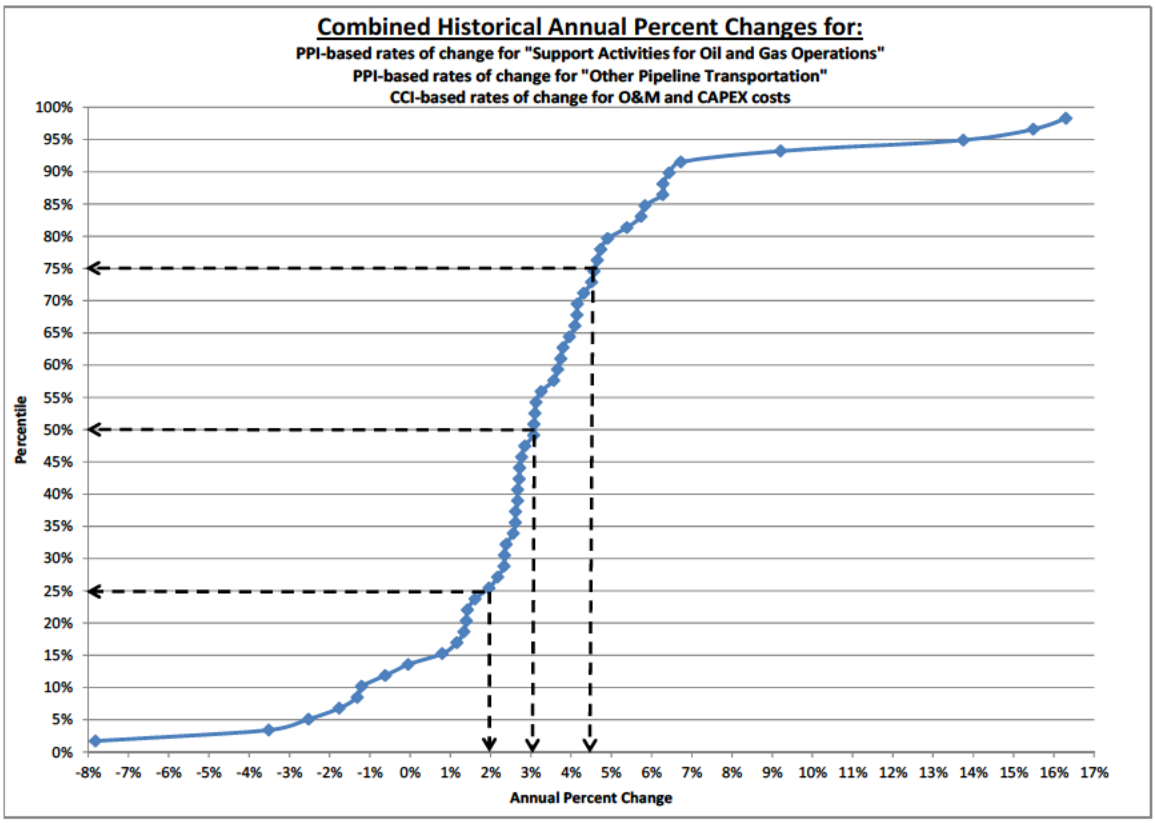
5. Economic Analysis

Because the staff memorandum finds the economic analysis performed by the Gas Utilities to be "robust," and because all of the alternative analyses performed by staff confirm that the proposed long-term gas storage and transportation arrangements will benefit customers in all but the most extreme worst case scenarios, the Gas Utilities comment on only two aspects of staff's economic "stress testing" of the Bluewater proposal: the discount and cost escalation rates used in those analyses.

First, the use of a higher, marginal discount rate would be appropriate only if WEC or the Gas Utilities were proposing to acquire Bluewater and continue operating it to provide storage services to third parties in interstate commerce, which would involve significantly higher risk than dedicating the facility to public utility service. Because the Gas Utilities are proposing to dedicate Bluewater to retail public utility service (as are the Manlove and Portello storage facilities owned and operated by the Gas Utilities' utility affiliates), a marginal discount rate overstates the risk associated with acquisition.

Second, staff's study of higher cost escalation rates is incomplete because the higher rates were applied only to Bluewater's costs. In other words, staff's analysis assumes that Bluewater's costs will increase faster than the costs of other storage facilities. It is difficult if not impossible to conjure reasons why Bluewater's year-to-year costs might increase more than the alternatives, much less to this degree. Even so, this staff "stress test" shows that the Bluewater proposal will generate savings in all but the most extreme case, in which Bluewater's costs escalate at 9% a year for 60 years while the cost of other storage in the market increases at only 3% annually.

To put staff's growth rate sensitivity analysis in context, the Gas Utilities' 3% growth rate was based on three historical indices specific to the gas industry. These indices included a combined 58 years of annual growth rates. As shown in the graph below, costs increased by less than 3% in half of those years and by more than 3% in the other half. But in only 11 instances did costs increase by more than 5%, and in only four did they increase by more than 7%. Thus, sustained growth rates above 3% are highly unlikely.



In addition, as discussed in the Application (at 16), it is far more likely that Bluewater's overall costs will increase at a lower rate than the costs at other storage facilities because Bluewater is a newer storage facility and will require less modernization and fewer upgrades to comply with new safety and environmental requirements than older facilities in the region.

6. Reopeners (Potential Conditions 6-9)

Staff proposes four conditions with a singular purpose, namely to reserve authority for the Commission to revisit the reasonableness of the gas storage agreements in the future. These conditions create the potential that the Gas Utilities' continued recovery of their costs under the long-term gas storage agreements could be disallowed. This would leave WEC shareholders with the stranded costs associated with the continued ownership and operation of Bluewater. Potential Condition 6 would allow the Commission to reconsider the reasonableness of the agreements periodically, perhaps every 10 or 15 years. (Staff Mem. at 20) Potential Condition 7 would require a provision in the agreements permitting cancellation or renegotiation "if events materially affecting the economic savings of the proposed transaction occur." (Staff Mem. at 21) Potential Condition 9 would allow the Commission to review the agreements under the "used and useful" standard every 3 years. (Staff Mem. at 27) Potential Condition 8 would require the Gas Utilities to periodically submit information verifying the savings from the Bluewater proposal, presumably to provide support for triggering any of the other three conditions should the terms of the gas storage service agreements turn uneconomic. (Staff Mem. at 21) It would also add a layer of accounting and tracking that could require additional staffing to accomplish, if the parties were even able to agree upon the standards that would be used to measure such savings.

These conditions are inconsistent with the structure and intent of the Bluewater proposal to mirror the Gas Utilities owning Bluewater and dedicating it to public utility service for the duration of its operating life, like the Manlove and Partello storage facilities owned and operated by the Gas Utilities' utility affiliates. When a Wisconsin public utility seeks to construct or acquire a sizeable asset like a power plant, the Commission determines whether the asset is

needed and reasonable in light of the utility's alternatives at the time of the decision. The fact that the asset will have a long operational life is accounted for in the economic analyses. It is at least implicitly recognized that customers will bear the risk of obsolescence, as Commission approval is never conditioned on later revisiting the decision to construct or acquire. Rather, if the Commission concluded that the construction or acquisition presents excessive risk to customers, it would simply deny the request to construct or acquire.

A recent example is Wisconsin Power and Light Company's ("WPL") Riverside project. This gas-fired combined-cycle electric generation facility is every bit as much of a "bet" on the continued abundance and low cost of natural gas as the Gas Utilities' proposal to acquire long-term gas storage capacity. Indeed, the Bluewater proposal is justified in large part upon the continued increase in use of natural gas for electric generation and the resulting increase in demand and cost of gas storage. But the Certificate of Public Convenience and Necessity for the Riverside project contained none of the types of reopeners staff proposes for the Bluewater proposal, even though WPL's customers will be fully responsible for the Riverside project's prudent capital costs. That is because the Commission determined <u>at the outset</u> that the risk/reward balance for the long-term commitment favored customers even with the future risk and uncertainty. Precisely the same is true with respect to the Bluewater proposal.

The reopener conditions would imperil WEC's rationale for acquiring Bluewater because they are wholly one-sided. The conditions would only shift risk to WEC, including the risk of stranded investment in the unlikely circumstance that the long-term storage agreements became uneconomic. Until then, customers would reap all of the benefits of Bluewater without compensating shareholders for bearing the stranded investment risk. If such conditions were imposed on the construction or acquisition of new plant by a public utility, it would never

proceed, at least not without an authorized return premium and/or some other offsetting compensation for the heightened risk.

Instead of considering reopeners that would shift risk to the Gas Utilities' shareholders without any corresponding benefit or reward, and thereby destroy the business case for acquiring Bluewater, the Commission should decide whether the risk to customers under the Bluewater proposal is essentially the same as it would be if the Gas Utilities owned Bluewater outright. The Gas Utilities submit that is the case.

The case for acquiring gas storage now is a compelling one. (Application at 10-15) While it is certainly true that there will be changes in the natural gas market over Bluewater's remaining operational life, there is no reason to believe that the Gas Utilities will not continue to need to store gas in their provision of retail gas service. The acquisition of Bluewater and its dedication to the Gas Utilities' retail gas service will cover only about one third of their gas storage needs and only 25% of their current peak day needs. If the Gas Utilities need less storage in the future, they will be able to roll out of their requirements served by other, shorter-term lease arrangements.

The staff memorandum expresses concerns about a potential catastrophic event over the 60-year contract term, but a gas leak such as the one that occurred at Aliso Canyon in California in 2015-2016 is highly unlikely at Bluewater and it would not be on the same scale. With 115 wells and 81.5 Bcf of working storage capacity, Aliso Canyon is the fifth largest natural gas storage facility in the United States. It is also one of the oldest, a depleted oil reservoir converted to natural gas storage in the 1970s. The Aliso Canyon reservoir is very deep − 8,750 feet or over one and a half miles. A breach in the casing of a well originally installed in the 1950's caused a significant gas leak from October 2015 to February 2016. After multiple failed attempts to "kill"

the well from the surface by pumping materials into the top of the well, it took three and a half months to drill a relief well to intercept the well near the bottom and pump materials into it to stop the flow of gas.[6]

By contrast, Bluewater was placed into service in 2005 with 23.2 Bcf of working storage capacity and 9 injection/withdrawal wells at a depth of about 3,000 feet. The Gas Utilities' due diligence found a rigorous well logging program in place and records confirming the excellent condition of the facilities' wells (neither of which were present at Aliso Canyon). The incident at Aliso Canyon has resulted in new industry and FERC safety regulations that will affect all storage facilities, but will likely have greater cost impact on older facilities. While there can be no guarantees against catastrophic events, the Gas Utilities' due diligence and the new regulations indicate a very low risk of such an event occurring at Bluewater.

Against the relatively low risk associated with the Gas Utilities' virtual ownership of Bluewater, their customers will receive 100% of the benefits. At least for the foreseeable future, the domestic supply and demand for natural gas will increase. Current and future market participants, including increased numbers of gas-fired electric generation facilities, will seek storage capacity to manage their gas supplies and usage. Yet the geologic formations that offer gas storage opportunities are limited, especially in the Midwest. All of these factors − discussed at length in the Application (at 8-10, 11-15) − point to increased demand for, potential scarcity of and higher cost of gas storage. The opportunity to acquire a significant quantity of storage for the exclusive use of the Gas Utilities' customers offers both cost savings in the current market and a hedge against scarcity and higher costs in the future.

[6] Interagency Task Force on Natural Gas Storage Safety, *Ensuring Safe and Reliable Underground Natural Gas Storage* 18-22 (Oct. 2016). *See also* the materials available online at http://www.cpuc.ca.gov/aliso/

The Gas Utilities respectfully submit that the Commission's focus should be on ensuring that the Bluewater proposal provides customers with a risk/benefit balance similar to utility ownership of gas storage. The Gas Utilities seek to accomplish this by providing for the prior approval of significant capital expenditures. These are the largest source of potential increased costs from the facility, particularly those that may be imposed on Bluewater by regulatory agencies.

With respect to annual O&M costs, the proposed gas storage agreements would allow BGS to pass through its actual O&M costs without any mechanism for Commission oversight. This is not a large risk, however, as the Gas Utilities are confident in their ability to manage those costs through their own personnel and resources as well as those of their affiliates. (See Application at 16) Because O&M costs are passed through to customers without a return, there is no financial incentive for BGS to incur additional cost.

The proposed pre-approval process for significant capital expenditures will adequately protect customer and shareholder interests even in the worst of cases. In the very unlikely event that gas storage would no longer be used or useful for the Gas Utilities' retail gas services, then presumably the utilities would not approve any additional capital expenditures. Presumably this would spell the end of operations for Bluewater (not to mention Manlove, Portello and every other gas storage facility). As with any other public utility asset that is shut down before the end of its depreciable life, the Gas Utilities and their customers would remain responsible for the remaining book value of the facility over the remaining term of the gas storage agreements. Again, customers would be in the same benefit/risk position that they would with any asset owned by the utilities.

7. Recovery Through the PGAC (Potential Conditions 9-11)

The staff memorandum identifies several criteria that the Commission has used to determine which costs may be recovered through a gas utility's Purchased Gas Adjustment Clause ("PGAC"). (Staff Mem. at 24) For the most part, staff also expresses agreement that the Bluewater proposal meets these criteria and that it would be reasonable for the Gas Utilities to recover their costs through their PGACs. (Staff Mem. at 26)

- <u>Reliable service would be maintained</u>. The acquisition of Bluewater would permit the Gas Utilities to lock in pricing and other terms and conditions for virtual ownership of storage capacity, a physical hedge that was not possible in their portfolios until now. Accordingly, this acquisition not only maintains but actually improves the Gas Utilities' reliability.

- <u>Sharing of risk and reward should be balanced between shareholders and ratepayers</u>. The "risk and reward" balance between the customer and the shareholder will be essentially the same under the Bluewater proposal as it is today. The Gas Utilities contract for gas storage services with Bluewater and other providers today and recover their costs through their PGAC mechanism. Accordingly, the Gas Utilities' continued recovery of Bluewater costs through their PGACs is reasonable and appropriate.

- <u>PGAC should provide appropriate price signals</u>. Storage charges are currently recovered via the PGAC mechanism from retail sales customers as the charges are incurred, and the Gas Utilities propose to continue this recovery methodology. Delaying recovery of the Bluewater storage costs until some future rate case, as staff suggests, would prevent timely cost recovery and limit the ability of the Gas Utilities to send appropriate price signals to their customers. In addition, the recognition of costs only in base rates would aggravate this untimeliness because rate cases are not generally filed on an annual basis,

resulting in accumulated deferral balances and limited opportunities to pass through costs to those customers actually receiving the benefits of the storage capacity.

- Operation of PGAC should not unduly hinder the transition to workable markets. The proposed acquisition requires a filing with FERC demonstrating that the new owner (WEC) will not have market power after the transaction has closed. Recovery of costs via the PGAC will not impact this finding.
- PGAC designed to achieve the lowest reasonable cost of gas via the submission of gas supply plans. The proposal provides a substantial net present value benefit to customers. In addition, utilizing the currently authorized weighted average cost of capital of the Gas Utilities in the recovery of the investment instead of assessing a higher, project-specific cost of capital to the transaction (likely the 13-17% return on equity identified in the staff memorandum) provides customers with the benefit of the lower-cost utility capital structure.
- Commission must have detailed and timely information. Information about the Gas Utilities' usage of Bluewater storage will be available to the Commission on an annual basis via the gas supply plan, whereas recovery in base rates will result in less frequent opportunities for review and action.
- PGAC should minimize the need for retrospective review of utility transactions. The very purpose of the Gas Utilities' declaratory ruling requests and their proposal to recover only the actual costs incurred by Bluewater via the service agreements and true-up adjustment feature is to specifically minimize the need for retrospective reviews.

For these reasons, the Gas Utilities' recovery of Bluewater's costs through their PGACs is both reasonable and appropriate.

Finally, staff proposes a condition requiring a triennial review of the Gas Utilities' PGACs. Such reviews are unnecessary. In the event that the Commission determined in the future that it would be reasonable to move the recovery of certain costs from the PGACs to base rates (or vice versa), there must be an opportunity for the Gas Utilities to change their base rates accordingly. Because this is usually only possible during a base rate case, and because base rate cases do not occur on a triennial basis, a triennial review of PGACs could lead to timing discrepancies resulting in deferrals of costs or refunds. The Gas Utilities recommend that any Commission review of PGAC scope take place in base rate proceedings where both base and PGAC rates are determined concurrently.

Conclusion

WEC and the Gas Utilities have developed an innovative proposal to provide the Gas Utilities and their customers a long-term source of gas storage capacity at cost, just as if they acquired a gas storage facilities themselves. As with a utility-owned asset, all of the benefits of owning Bluewater will be passed on to customers and no benefits have been withheld for shareholders. The staff memorandum overall expresses no material concerns with the Bluewater proposal, but suggests potential conditions that could be imposed to transfer risk from the Gas Utilities' customers to WEC shareholders with no corresponding benefit. Instead of considering reopeners that would preclude the execution of this proposal, we ask that the Commission declare that it is reasonable and prudent for the Gas Utilities to acquire long-term rights to a gas storage facility akin to ownership as set forth in the long-term gas storage service agreements, and to recover their costs incurred under those agreements through their PGACs.

Dated this 15th day of May, 2017.

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